STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a session of the Public Service Commission held in the City of Albany on February 27, 2002

COMMISSIONERS PRESENT:

Thomas J. Dunleavy, Presiding
James D. Bennett
Leonard A. Weiss

CASE 00-C-1945 - Proceeding on Motion of the Commission to Consider Cost Recovery by Verizon and to Investigate the Future Regulatory Framework.

CASE 98-C-1357 - Proceeding on Motion of the Commission to Examine New York Telephone Company's Rates for Unbundled Network Elements.

ORDER INSTITUTING VERIZON INCENTIVE PLAN

(Issued and Effective February 27, 2002)

BY THE COMMISSION:

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INTRODUCTION

When we instituted the Verizon New York Inc. (Verizon) regulatory proceeding in November 2000, the Commission intended an examination of the emergence and status of the competitive market for local telecommunications service in New York, with concomitant modifications to the Verizon Performance Regulatory Plan then in effect. This proceeding, along with the concurrent litigation of wholesale rates in Case 98-C-1357, encompassed the range of issues fundamental to establishing a framework for the next generation of local competition in New York, as envisioned by the Telecommunications Act of 1996 (the 1996 Act). In November 2001 we asked the parties to this proceeding to explore the possibility of a comprehensive joint proposal for the Commission to consider integrated solutions to the closely intertwined issues of a distressed competitive marketplace, Verizon's retail prices, service quality protections, incentives to invest in New York's infrastructure, and the public interest in promoting all forms of competition.[1] We gave the parties 60 days. On February 8, 2002, Verizon and Department of Public Service Staff (Staff) filed a Joint Proposal Concerning Verizon Incentive Plan (VIP or Plan), attached to this order as Appendix A. Most competitors joined them.

We find the terms and provisions of the Joint Proposal, in the context of our wholesale rate decision issued in January 2002, to provide a proper balancing of the interests of customers, competitors, the incumbent, and the economic development of New York State and to produce just and reasonable rates with a guarantee of safe and adequate service. We adopt the terms of the Joint Proposal as discussed herein, and put in place a Verizon Incentive Plan to create the framework and conditions to allow and encourage all forms of competition in New York. The retail rate flexibility that we accord Verizon by this order is premised upon the existence of such competition and on the continuation of adequate service.

[1] Cases 00-C-1945 *et al,* Order Granting Staff Motion (issued November 30, 2001).

PROCEDURAL HISTORY

In November 2000 we instituted a proceeding "to resolve outstanding issues regarding the recovery of certain costs sought by Verizon New York Inc.; to consider the potential modification of [Verizon's] Performance Regulatory Plan (PRP), pursuant to conditions included in our approvals of its past mergers; and to consider emerging issues related to the development of a vibrant competitive marketplace and the future regulatory regime that may be appropriate following the conclusion of the PRP."[2] The first step in that process, as contemplated in our order, was the issuance by Staff, on January 2, 2001, of a White Paper setting forth its analysis of the exogenous costs and competitive cost onsets that might be recoverable by Verizon under our orders approving the two mergers (NYNEX/Bell Atlantic and Bell Atlantic/GTE) that led to its formation.[3]

In a series of rulings that reflected, in part, a conference with the parties held on February 13, 2001, Administrative Law Judges Joel A. Linsider (Litigation Judge), Jaclyn A. Brilling and Eleanor Stein (Settlement Judges) invited comments on the Staff White Paper and elaborated on the scope of and schedule for the proceeding.[4] Comments and reply comments on the White Paper were duly filed and, consistent with the judges' rulings, Verizon on May 15, 2001 filed its financial data and a proposal, with supporting testimony, for a future regulatory plan. Presentations by other parties were to be filed on

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[2] Case 00-C-1945, Order Instituting Proceeding (issued November 3, 2000), pp. 1-2.

[3] Cases 96-C-0603 et al., NYNEX/Bell Atlantic Merger, Opinion No. 97-8 (issued May 30, 1997); Case 98-C-1443, Bell Atlantic/GTE Merger, Order Granting Approval of Merger (issued August 12, 1999).

[4] Case 00-C-1945, Ruling Inviting Comments and Convening Conference on the Scope of the Proceeding (issued January 2, 2001); Ruling on Scope and Schedule (issued February 27, 2001); Ruling on Request for Clarification (issued April 6, 2001).

August 13 but, by letter dated August 1, Verizon requested that discussions be initiated and that the litigation schedule be suspended. In a ruling issued August 6, Judge Linsider suspended the litigation schedule.

The parties' discussions were scheduled to begin on September 11, 2001 in New York City. That meeting was of course cancelled as the terrible events of that day unfolded, and talks were postponed to allow Verizon and other parties to direct all their efforts to recovery. Discussions resumed in December 2001 and continued into early February 2002, with Judge Stein serving as mediator throughout. Participants are listed in Appendix B.

Concurrently the final stages of litigation were going forward in Module 3 of the Second Network Elements Proceeding (Case 98-C-1357), an examination of the pricing of Unbundled Network Elements (UNEs). A recommended decision had been issued in May; briefs and reply briefs on exceptions had been filed, and the case was being prepared for presentation to us. That process as well was delayed by the September 11 attack, and we invited parties to submit comments on the extent, if any, to which the attack and its aftermath might have a bearing on the issues in that case. We later granted a Staff motion to hold the UNE rate decision in abeyance and consolidate UNE issues with the resumed discussions in this proceeding, but we limited that process to 60 days.[5] A joint understanding incorporating UNE rates generally was not reached, and we considered UNE rates at our January session and issued our decision on January 28, 2002.[6] In that decision, we remanded for further discussion among the parties the issue of potential refunds resulting from the decrease in previously temporary rates for switching elements. Intensive mediated efforts in this proceeding continued, ultimately producing the Joint Proposal here before us for consideration.

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[5] Cases 00-C-1945 and 98-C-1357, Order Granting Staff Motion (issued November 30, 2001).

[6] Case 98-C-1357, Order on Unbundled Network Element Rates (issued January 28, 2002)(UNE Order).

Following its submittal by Verizon and Staff, the Joint Proposal was executed as well by ACC Telecom Corp., Allegiance Telecom of New York, Inc., AT&T Communications of New York, Inc. (AT&T), BridgeCom International (BridgeCom), Broadview Networks (Broadview), Communications Corporation of New York, Conversent Communications of New York, LLC, Focal InfoHighway Communications Corp. (InfoHighway), RCN Telecom Services, Inc., Talk America, Inc., TCG New York, Time Warner Telecom (Time Warner), XO New York, Inc. and Z-Tel Communications, Inc. (Z-Tel). Statements supporting the Joint Proposal were submitted by Verizon, Staff, Worldcom, Z-Tel, BridgeCom, and Cablevision Lightpath; Covad stated it did not oppose. Responsive comments were submitted by the Attorney General, CompTel, PULP, Assemblyman Richard Brodsky, and ChoiceOne. An evidentiary hearing before Chairman Helmer and Chief Administrative Law Judge Judith A. Lee was held in Albany on February 19, 2002; the record comprises 671 pages of stenographic transcript and 15 exhibits. At the conclusion of the hearing, closing statements in lieu of initial briefs were presented by PULP, the Attorney General, AT&T, WorldCom, Allegiance, Focal, Time Warner, Z-Tel, BridgeCom, William Thornton on behalf of Assemblyman Richard Brodsky, Verizon and Staff. Replies were submitted by Staff, Verizon, PULP, and BridgeCom. In addition, public comments were received via a special channel on our toll-free opinion line and by e-mail via the comment form on our website.

SUMMARY OF THE JOINT PROPOSAL[7]

The proposed Verizon Incentive Plan (VIP) would have a term of two years, beginning March 1, 2002. The associated Service Quality Plan (SQP) would extend an additional year, through February 28, 2005. The VIP and SQP would govern

[7] This summary is provided only for the reader's convenience and in no way supersedes or modifies the terms of the Joint Proposal itself. It is not exhaustive, and an omission of a reference to any particular term of the Joint Proposal is of no import.

Verizon's retail and wholesale rates; relations with its competitors; service quality; accounting, pension, and other regulatory matters; and infrastructure.

The following findings, expectations, and requirements are premises of the plan:

- Verizon's service quality performance is generally satisfactory, and a service quality plan is in place to prevent backsliding.
- Active competition will exist across all market segments.
- Unbundled network element (UNE) rates will be as set in the UNE Order.
- The UNE Platform (UNE-P) will remain available in accordance with then-Bell Atlantic-New York's April 6, 1998 Pre-Filing Statement (PFS) as here modified.
- Facilities-based competition will continue to develop.

Rates

The VIP affords Verizon flexibility with respect to its rates, subject to specified conditions, exclusions, and limitations. General conditions of pricing flexibility include the following:

- The overall revenue increase associated with pricing flexibility may not exceed 3% on an annualized basis in each Plan Year.
- Pricing flexibility may be suspended pursuant to the terms of the Service Quality Plan.
- Verizon must take full responsibility for explaining to its customers the need and rationale for any price increase and must explain that the price increase is based solely on its own business decision.
- Downward rate flexibility is unlimited, except that the rate for any product or service must exceed or equal its

incremental cost and usage offerings must pass an imputation standard.

Verizon will be afforded upward rate flexibility for all products and services consistent with the Service Quality Plan except the following:

- Carrier access services
- UNEs
- Wholesale discounts for services offered for resale
- Interconnection and reciprocal compensation
- Lifeline services
- Maintenance and access to the ALI database
- Directory assistance and other database inquiries for competitive providers
- Non-recurring service connection charges for residential and small business customers
- Certain services previously ordered to be provided at no charge.

Where upward rate flexibility applies, there is no cap on the rate for any individual service except that:

- No increase in the charges for First Line Basic Service shall exceed $1.85 per line in the first year and $0.65 per line in the second year.
- The total price for 1FR service[8] in Rate Group 1 shall not increase by more than $2.00 in the first year of the Plan and $2.00 in the second year of the Plan.
- The total price for 1FR service in Rate Groups 3 and 5 shall not increase by more than $2.00 in the first year of the Plan and $3.00 in the second year of the Plan.

[8] This service is a residential service consisting of the basic line charge and flat-rate local usage.

Unbundled Network Elements

For the term of the VIP, and regardless of any changes in its obligations under federal law, Verizon will make the UNE Platform available to CLECs serving small business customers on the pricing and duration terms applicable, under its PFS obligations, to CLECs serving residential customers.

Rates for UNEs are those set in the UNE Order, as specifically set forth (with respect to the main UNEs and the UNE-P) in Appendix A to the Joint Proposal, and Verizon will not contest those rates, either before us or in court. The sole exception to those rates is that the non-recurring charge for two-wire and four-wire hot cuts will be limited to $35. (The difference between the higher charge set in the UNE Order and the $35 charge under the VIP will be applied as a bill credit.) That limitation, agreed to by Verizon in order to arrive at a joint proposal, is part of the proposed treatment of refunds on account of the switching rates kept temporary in the First Network Elements Proceeding; other aspects of the refund treatment are as follows:

- Verizon will provide a "Forward Fund" of $15 million that will satisfy any potential liability for refunds, net of any reciprocal compensation payments due and owing to Verizon.

- Payments will be made only to CLECs that operate within the State; that paid the temporary switching rate; whose hot cuts in 2001 did not exceed 5,000; and that relinquish any other claims for retroactive payments related to switching rates.

- The Department of Public Service will conduct an expedited process to allocate the Forward Fund among eligible CLECs. Payments to CLECs will be 50% in the form of direct payments and 50% in the form of bill credits over a six-month period.

- Verizon will give up any claim to recovery of reciprocal compensation overpayments on account of excess switching rates.

Competitive Enhancements

Verizon agrees to cooperate in a task force that will work toward establishing processes and procedures to standardize efficient wholesale transactions in several specified areas including billing and collection, building access, and efficient provisioning for services where no facilities are available. The task force will report to us within three months of the issuance of this order.

Verizon will also participate in a task force to work with CLECs and Staff to solve urgent facilities, hot-cut and other bottleneck problems. That task force will report to us within six months.

Service Quality

The Service Quality Plan establishes a series of performance objectives, compliance with which is to be periodically reviewed. Failures to meet objectives are subject to various outcomes, depending on the nature and severity of the failing. These include suspension of pricing flexibility and rate credits of up to $100 million for failure to meet three objectives plus $35 million for each additional objective not met. The Plan includes detailed provisions for the calculation and distribution of these payments. In addition, Verizon undertakes to pay $100,000 into the State's general fund in the event of certain major service interruptions and to implement a special services process improvement program. The Plan details procedures to ensure the accuracy of service quality measurement.

Financial Consistency and Additional Regulatory Protections

The VIP provides for Verizon's PSC regulatory financial figures and depreciation reserve to be gradually conformed to those used in its filings with the Securities and Exchange Commission. Existing regulatory assets and liabilities are to be extinguished by the end of the VIP's term and no new ones are to be created except with respect to World Trade Center restoration. Any changes to Generally Accepted Accounting Principles (GAAP) are to be adopted for both SEC and state regulatory purposes under the plan.

Verizon will account for pensions and other post-employment benefit (OPEB) obligations in accordance with SFAS #87 and SFAS #106. In addition,

- Verizon will not withdraw plan assets other than to pay benefits (including administrative expenses) or settle benefit obligations associated with pension and OPEB plans.
- Verizon will not annuitize, curtail, or otherwise settle its pension or OPEB obligations to employees of regulated entities in New York without our prior approval.
- Verizon will notify us of major changes in pension or OPEB plans, material changes in assumptions, or use of plan benefits for purposes other than pensions and related administrative expenses.

Infrastructure

To ensure investment commensurate with good service quality, Verizon will

- File annual construction budgets that identify service-related investments
- Meet annually with Staff to review its construction budget, with emphasis on several specified areas

- Report annually on plans and progress related to new technology and new services.

To ensure reliability consistent with post-September 11 best practices, Verizon will

- By July 1 of each year, inform Staff of its intention to implement changes, reflecting lessons learned from incidents such as the September 11 attack, to the Network Reliability and Interoperability Council's best practices and industry standards; and report annually to Staff on its progress toward implementation

- Participate in industry/government forums on network reliability

- Cooperate in developing data to be used by Staff in its Geographic Information System designed to provide service outage information.

Miscellaneous Provisions

The Joint Proposal would resolve outstanding issues related to exogenous cost recovery and merger savings (the so-called "White Paper" issues). It would have us find that available merger savings fully offset otherwise allowable cost onsets and exogenous costs; and that ordering clauses 5 and 6 of the orders approving the NYNEX/Bell Atlantic merger and the Bell Atlantic/GTE merger had been satisfied such that Verizon relinquishes any claim to rate increases associated with exogenous costs and that merger savings will not be used as a basis for rate reductions. Verizon likewise would withdraw its recent request for recovery of OSS costs associated with various DSL-related items.

The Joint Proposal includes a provision reserving our authority to act on the level of Verizon's rates and service should circumstances render Verizon's rates unjust or unreasonable or render the Plan unreasonable, unnecessary or insufficient for the continued provision of safe and adequate service by Verizon. In addition, Verizon agrees not to challenge the rates set in the UNE Order before us or in court, during the term of the plan, though it does not thereby relinquish any rights elsewhere with respect to the underlying theory of the case, including the use of TELRIC costing.

The Joint Proposal would defer, to the end of the VIP's term, the review of rates for the loop/switch interface that would otherwise take place, pursuant to the UNE Order, in May 2002.

Verizon agrees to reduce the connection charge for Lifeline service from $10 to $5. In addition, it will maintain an outreach and education program for Lifeline. More generally, it will design and carry out, within existing consumer education budgets, a commitment to inform customers about their rights, responsibilities and special programs.

RECORD EVIDENCE AND STATEMENTS IN SUPPORT

Verizon

In testimony submitted with the Joint Proposal, Verizon characterizes the plan as "an important step toward establishing appropriate incentives for Verizon NY and other carriers to invest in and develop telecommunications facilities in the State of New York and to engage in full-fledged competition, governed by market forces and not unduly restrained by regulation."[9] It regards the plan as especially important following issuance of the UNE Order which, it asserts, imposes regulatory constraints on Verizon's wholesale business that make it even more important for Verizon to be able to compete on a level footing in the retail marketplace. Verizon believes as well that its good service quality performance warrants revisiting its service quality obligations and that conforming its regulatory financial reports to its SEC reports properly reflects the competitive marketplace. Verizon regards the VIP as consistent with our "policy of substituting market discipline for direct regulatory intervention where there is evidence, as there is here, that such market discipline will have the desired

[9] Verizon's Prefiled Testimony, p. 7.

effect,"[10] but adds that the plan maintains adequate regulatory safeguards even as it allows Verizon increased flexibility to respond to market forces.

With reference to the Plan's pricing flexibility, Verizon contends generally that the growth in competition in the New York telecommunications market obviates detailed price regulation; that pricing flexibility benefits consumers by enabling Verizon to deploy pricing plans more responsive to consumer needs; and that Verizon needs pricing flexibility to respond to its competitors, who already have virtually total pricing flexibility. It urges elimination of asymmetric regulatory constraints that, in its view, prevent competitors from charging cost-based prices, encourage market inefficiencies by allowing its competitors to capture customers simply by reason of their regulatory advantages, and diminish the incumbent's ability to innovate. Verizon adds that affording it the opportunity to compete and obtain a reasonable return on its investment is particularly important in view of the UNE Order, which makes entry more attractive to other carriers. It adds that only the prospect of adequate levels of return will provide it the economic rationale to invest in its network, which makes up a substantial part of the State's telecommunications infrastructure. At the same time, strong and increasing competition will preclude Verizon from profitably raising prices above competitive levels, and increases in the charges for first line basic service are limited.

More specifically, Verizon argues that the 3% annual limit in increased annual revenues is reasonable, among other things, in light of the trend of change in cost of living. It notes that the 3% is a ceiling, that rate increases are not required, and that they would be imposed only if Verizon concluded that the market warranted them. It asserts that the relatively small increase allowed in basic service rates, even if applied, would still leave telephone service affordable; that increased competition benefits consumers by providing them more

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[10] Id., pp. 9-10.

choice and better value; and that Lifeline rates will not be raised and that the Lifeline connection charge will in fact be reduced to $5.

Verizon estimates the following revenue effects in 2002 associated with price changes under the VIP[11]:

Rate Change	Revenue Effect in 2002
$1.85 per line increase	$120.6 million
Other changes up to 3% maximum	$15.3 million
New UNE-P and UNE-L rates	($227.2 million)
Switching rate refund	($15 million)
Credit on hot cut NRC	($2.5 million)

Verizon includes with its filing financial projections for the years 2002-2004[12] and suggests that its calculated returns are below any fair and reasonable range of returns that we might set in a rate case and are, in fact, optimistic: they contemplate exercise of the full 3% pricing flexibility, which might be precluded by market conditions; they assume payment of no service quality penalties; and they are based on the earlier projections, filed May 15, 2001, which are likely to prove optimistic in light of economic conditions generally and the aftermath of the September 11 attack.

With regard to service quality, Verizon notes that it has made substantial investments to meet or exceed the service quality standards imposed under the performance regulatory plan about to expire and that the new three-year service quality plan (SQP) associated with the VIP insures continued high-quality service. In contrast to the PRP service plan, which was designed to encourage the capital investments needed to improve service, the VIP service quality plan recognizes the improvement that has been achieved and is designed to prevent backsliding from those levels. Pointing to the SQP's statewide performance objectives, the availability of credits for customers if those objectives are not met, and our authority to suspend pricing

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[11] Verizon's Prefiled Testimony, pp. 33-34.

[12] Id., pp. 17-18.

flexibility if two performance objectives are missed in a single review period beginning on or after February 28, 2003, Verizon explains that the plan uses regulation to set minimum service quality standards but that competitive forces will likely require all market participants to exceed that regulatory floor. Verizon notes that the SQP is designed to prevent poor performance in any part of its service area, explaining why it believes the performance objectives to be appropriate, and describing how the enforcement mechanisms--payments and the potential suspension of pricing flexibility--are crafted in a way that will require consistently high levels of service quality. It notes as well that the provisions to ensure accurate service results borrow heavily from the analogous provisions of the PRP but include a number of new items, among them a process being developed with the Communications Workers of America for the investigation of allegations of service misreporting.

Verizon explains that the plan to conform its PSC books to GAAP accounting is warranted because the increasingly competitive telecommunications market obviates the separate accounting records associated with a rate-base/rate-of-return regulatory regime. The transition's effect on customers, if any, would be a benefit associated with the write-off of a substantial amount of rate base through accelerated depreciation.

Overall, Verizon asserts that the VIP ensures high-quality services at affordable prices, and provides Verizon NY with the flexibility it needs to compete in today's market and with the incentives to continue to invest in New York.

Staff

Staff believes the Joint Proposal "is both in the public interest and consistent with the Commission's pro-competitive and economic development policy initiatives."[13] The Plan's goals, according to Staff, include the stimulation of

[13] Staff's Prefiled Testimony, p. 3.

competitive market forces so that customers benefit from investment in new technology, which produces innovation and choice. Staff expects competition will discipline prices in a manner that will permit customers to avoid the price increases authorized by the VIP should Verizon put them into effect. The expanded availability of UNE-P for small business customers and benefits for UNE-L competitors will introduce greater competition into the small business market and strengthen opportunities for economic development. The special services process improvement program will improve provisioning performance for high capacity circuits, thereby aiding economic development. The retail service quality and infrastructure components of the VIP preclude Verizon from enhancing its earnings by sacrificing good service quality, while the existing performance assurance plan continues to ensure high wholesale service quality for CLECs. The plan includes additional protections for Lifeline customers as well as an outreach and education program related to special programs.[14]

Staff expects the competitive enhancement task forces created under the plan will improve operating relationships between Verizon and its competitors. In addition, the financial consistency terms of the VIP will move Verizon's accounting and financial reporting to a method that reflects the actual competitive environment. Staff suggests that the reduced wholesale prices required by our UNE Order will increase local service competition around the State and across all customer groups, thereby warranting reduced regulation of Verizon's own retail rates and the price flexibility provided for in the VIP.

Staff identifies several features of the Plan that, in its view, well serve the public interest. Among them are the offering of the UNE platform to CLECs serving small business customers; the establishment of task forces to deal with issues that interest and concern CLECs; the improved provisioning and maintenance of special services; and the price flexibility afforded Verizon. Price flexibility is in the public interest,

[14] Staff's Prefiled Testimony, pp. 3-5.

Staff continues, because it will allow rates to move gradually to costs; because Verizon's return on equity will likely fall within a reasonable range for companies with similar risk profiles; and because customers may be able to avoid any price increases by looking to competitive providers. Staff points as well to the Plan's resolution of the switching rate refund issue and to its reduction of the non-recurring charge for hot cuts, additional steps that will contribute to the growth of competition.

Staff believes that the Plan will promote economic development, suggesting the Plan will advance economic development by enhancing competition; creating strong incentives for Verizon to maintain its improved service quality; encompassing a separate agreement by Verizon to improve the provisioning of special services,[15] which are critical to the State's information-based economy; and relaxing rate regulation. With specific reference to special services, Staff notes inadequacies in Verizon's past performance[16] and explains that Verizon has now agreed to introduce a management program designed to improve its provisioning performance and to insure that the services are properly maintained once in place. The program includes customer credits in the event of below-target performance and is designed to gradually improve service.

Staff places the pricing flexibility provisions of the VIP in the context of a telecommunications market that has become steadily more competitive and in which traditional rate regulation is no longer necessary. The caps on pricing flexibility reflect Verizon's continued position as the dominant, though no longer monopoly, provider of telecommunications service. Staff cites past actions by the Commission allowing pricing flexibility as markets have opened, such as with respect to terminal equipment.

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[15] Special services are a variety of dedicated point-to-point private lines services generally used by business for the transport of data and voice traffic.

[16] Citing Cases 00-C-2051 et al., Opinion No. 01-1 (issued June 15, 2001).

Staff offers a financial analysis explaining how Verizon's rates under the plan will be just and reasonable. It sees no basis for concern about Verizon achieving an excessive return over the course of the Plan, citing, among other things, competitive pressures on that return. Taking account of the reduced UNE rates and anticipated revenue increases associated with the Plan, Staff estimates, on Verizon's premises, earnings of 2.8% in 2002, 6.4% in 2003, and 4.6% on average.[17] With Staff's traditional rate-case type adjustments, those figures become 11.4%, 16.3% and 13.9%.[18] Staff suggests that a traditional regulatory model might have produced an authorized return only in the range of 11% to 12% rather than its forecast 13.9%, but it believes that the overall result is reasonable in view of Verizon's specific risk profile (which might have suggested a return at the 12% end of the range in a traditional analysis); the other benefits of the Plan, which justify allowing a somewhat higher return; and the prospect that Verizon will be unable to exercise the maximum pricing flexibility authorized by the plan, which would reduce the forecast return below 13.9%. Staff notes as well that over the term of the PRP, Verizon has earned below reasonable levels on both its own calculations and Staff's. Overall, in Staff's judgment, "given the Plan benefits, risks that confront Verizon in transitioning to competition, and the Commission's general reservation of authority, this Plan produces just and reasonable rates."[19]

Competitors' Statements

1. WorldCom

Urging us to adopt the terms of the Joint Proposal, WorldCom cites its recognition of the need for additional competitive enhancements to ensure that the local telephone

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[17] Verizon's own calculations in fact differ somewhat from these, but the difference is not significant for decisional purposes.

[18] Staff's Prefiled Testimony, p. 64.

[19] Staff's Prefiled Testimony, p. 83.

market in New York remains open and to promote active competition across all market segments. In WorldCom's view, the Plan's provisions, together with the recent reductions in UNE rates, should further our pro-competitive regulatory policies. It suggests that some aspects of the plan "could have been stronger in some respects,"[20] but it expects that those matters will be addressed in other proceedings here and before the Federal Communications Commission.

2. Z-Tel

Noting that the recent UNE rate reductions will lead Z-Tel to resume marketing efforts for residential customers in New York, Z-Tel cites the timing and certainty of the Joint Proposal as factors giving it significant value. It notes Verizon's agreement not to challenge the UNE rates and the assurance that the UNE platform will be available for at least two years for small business customers with up to 18 lines. It appends a study showing the benefits to competition and small business customers likely to flow from that provision. Z-Tel also endorses the $15 million pool related to switching refunds, though it suggests the full amount of overpayments would substantially exceed it.

Z-Tel supports the service quality provisions of the Plan because the quality of the service received by Z-Tel and other CLECs from Verizon at wholesale is generally required to be on a par with the service quality that Verizon provides to its retail customers. Z-Tel identifies as well some of the issues it believes may be productively addressed by the task forces created under the plan.

Z-Tel expresses support for our policy of encouraging the development of competitive markets and of using "output oriented, performanced based approaches to regulate areas that are not competitive."[21] Noting that competitive entry has stagnated over the last six months, Z-Tel suggests that the

[20] WorldCom's Statement in Support, p. 2.

[21] Z-Tel's Prefiled Testimony, p. 9.

added certainty afforded by the VIP with respect to the recent UNE rate reductions, the availability of the UNE platform, Verizon's wholesale performance, and the resolution of CLEC service delivery and billing problems will encourage competitors to resume their efforts to enter the market. Z-Tel considers the Joint Proposal to be in the public interest.

3. BridgeCom International

BridgeCom describes its goal in the proceeding as arriving at a "fair and equitable agreement which would encourage the development of competition in local exchange markets, while at the same time assuring improvements in service quality to all customers and protecting retail customers from unreasonable rate increases" and says "approval of the Joint Proposal will help achieve those goals."[22] BridgeCom cites several provisions of the Joint Proposal that it regards as essential to the continued development of competition in the local exchange market; these include Verizon's commitment not to challenge the UNE order, the expanded availability of the UNE platform without any "glue charge" (though BridgeCom does not waive its rights to continue to press for continuation of the expanded UNE platform beyond the two years of the plan), the limitation to $35 of the charge for hot cut conversions, and the resolution of the White Paper issues in a manner that precludes cost recovery.[23] Overall, BridgeCom asserts that "approval of the Joint Proposal will be in the best interests of business and residential consumers in this State, competitive carriers, Verizon itself, and the public at large. By encouraging the development of competition, the Plan will bolster the economy of this State and lead to use of new and efficient technologies, the introduction of more and innovative services, and the

[22] BridgeCom's Statement in Support, p. 1.

[23] BridgeCom requests in this regard that we confirm its understanding that the $.55 per line rate approved in the UNE order for OSS development and implementation costs will be withdrawn.

establishment of wholesale and retail rates which are just and reasonable."[24]

4. Cablevision Lightpath

While asserting that the UNE order and the Joint Proposal are the latest in a series of steps that demonstrate New York's commitment to the development of effective competition in the local exchange market, Lightpath urges us now to turn to the question of efficient and effective interconnection, an issue that it regards as paramount to facilities-based carriers in New York. It stresses the important role of facilities-based carriers and urges us, "as a complement to progress made on behalf of UNE-P competitors in the current proceeding, to address promptly the need for appropriate and effective measures to streamline interconnection."[25]

5. AT&T

AT&T notes that Staff, in its supporting testimony, stresses that it could not have entered into the settlement without a reasoned confidence that the new UNE rates would permit effective retail competition in all local markets, based upon its margin analysis. AT&T agrees with the Staff analysis that retail price competition based on UNEs could act as an effective alternative to retail rate regulation.

AT&T represents that, with the UNE rate decision and the settlement, it can compete aggressively across the broad spectrum of the local market. Without detailing its competitive plans, it intends to be a force in the New York market to compete in the short term and to invest for the long.

As to the grant of increased retail rate flexibility to Verizon, AT&T argues, the trade-off is exactly correct. The transition from monopoly to competitive conditions should always include a transition from regulated pricing to market-driven

[24] BridgeCom's Statement in Support, p. 5.

[25] Lightpath's Comments, p. 3.

pricing. It believes the current conditions will support price competition, and supports the timing of this decision.[26]

RESPONSIVE COMMENTS

Attorney General

Noting that his goals in the proceeding have been to promote and accelerate the growth of competitive local markets throughout the State and to ensure fair rates and treatment for retail ratepayers in the transition to those markets, the Attorney General believes the Plan's provisions are essential to the first of those goals but that they fall short of achieving the second, in that they rely too heavily on competitive markets to moderate Verizon's rates and ensure its service quality.

The Attorney General comments favorably on and supports the provisions of the VIP related to wholesale rates and other aspects of the relationship between Verizon and its competitors. He believes those provisions are "essential for New York to remain in the vanguard of competition and widespread customer choice," notes the widespread CLEC support for the VIP, and assumes those competitors "will now find it in their business interest to enter the New York market in strength."[27]

He asserts that "competition, especially for residential and small business customers, has not yet become enough of a reality so as to diminish the need for sufficient regulation of the dominant provider. The VIP should go far to further the transition. In the interim, Verizon-NY's retail ratepayers need more protection in the form of reasonable rates and incentives for good service quality performance than this plan now provides."[28]

Turning to matters of service quality, the Attorney General notes both the improvements since 1995 and the continued failure to meet some PRP targets and the penalties incurred by Verizon on that account. He therefore expresses concern that

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[26] Tr. 610-611.

[27] Id., p. 7.

[28] Attorney General's Comments, p. 2.

some of the VIP's service quality provisions fail to insure maintenance of past improvements in service performance. He suggests, among other things, that some performance objectives be disaggregated by district for purposes of assessing penalties (albeit it not for purposes of determining whether to suspend price flexibility) in order to ensure adequate performance in all regions. In addition, he favors more rigorous service quality objectives with respect to the customer trouble report rate and the PSC complaint rate. He suggests as well that penalty levels be graduated to reflect the magnitude of the shortfall from the target; that the "outlier" performance objective be made more rigorous and that a $100,000 penalty be imposed for each outlier; that the first review of Verizon's service quality performance take place six months, rather than one year, after approval of the Plan; and that pricing flexibility be suspended whenever a single annual performance objective is missed, rather than only if two or more objectives are missed, as the Plan provides.

With respect to rate increases and pricing flexibility, the Attorney General recognizes the need to strike a balance between regulation and deregulation as the transition to competition proceeds but expresses concern that the balance here may go too far in the direction of deregulation, given Verizon's continued status as the dominant provider of local service. He recommends as well that the transition from regulatory accounting to GAAP and SEC accounting take place over five years rather than over three in order to avoid creating excess revenue requirements associated with too fast a transition, thereby diminishing the need for 3% annual rate increases. He notes in this regard the FCC's rejection two years ago of a proposal by incumbent local exchange carriers to accelerate depreciation, and its determination that traditional depreciation rates could be waived only if the additional depreciation cost were booked below the line and thus borne by shareholders.

The Attorney General endorses the VIP's resolution of the White Paper issues, but expresses concern that the Plan cancels various other potential ratepayer benefits and claims. These include a $55 million penalty for Verizon's failure to meet one of the service quality standards associated with approval of the NYNEX/Bell Atlantic merger, as well as several other benefits potentially available to ratepayers under the PRP (which would be terminated six months earlier than its August 31, 2002 expiration date) and otherwise.

Finally, the Attorney General regards the two-year term of the VIP as appropriate, given the degree of uncertainty about the future development of competition and the potential need to reassess matters as soon as two years from now. He also notes favorably the provision recognizing our authority to modify or terminate the Plan in mid-term should intervening circumstances render Verizon's rates unjust or unreasonable.

<u>CompTel</u>

CompTel supports the Joint Proposal and notes favorably its pro-competitive enhancements, particularly those related to UNE rates and UNE-P availability. It urges us, however, "to ensure that the pro-competitive aspects of the Plan are implemented and enforced in the same spirit in which they were negotiated and resolved--that is, with dedication and perseverance."[29] In addition, it urges us to establish, before the Plan's expiration, a process to assess the need to extend the term for some of the pro-competitive provisions.

<u>PULP</u>

PULP expresses concern about the Joint Proposal's failure to address difficulties now being experienced in the telephone Lifeline program. PULP explains that although the New York telephone Lifeline program is "robust" in comparison to those in other states, enrollment has declined precipitously over the last five years. PULP attributes the decline to the fact that Lifeline enrollment is tied to eligibility for other low-income assistance programs and that as eligibility for those

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[29] CompTel's Comments, p. 2.

programs declines, so does access to Lifeline. To respond to the problem, PULP proposes that three programs be added to the list of those creating telephone Lifeline eligibility: The National Free/Reduced School Lunch Program, The State Earned Income Tax Credit Program, and the Child Health Plus Program. PULP suggests that each of these programs encompasses the same income levels as the existing programs and that they are unlikely to see significant shifts in enrollment resulting from welfare reform.

PULP asserts as well that if these additional customers were able to access the telephone Lifeline program, virtually all of the increased cost would be paid by the federal government through the Federal Universal Service Fund and the State Targeted Assistance Fund. As a result of those arrangements, any revenue gain to Verizon associated with the customer moving from Lifeline to non-Lifeline basic service would be offset by revenue losses resulting from reduced federal or state support money.[30]

In its closing statement and in reply, PULP asserts that expanding the number of programs that provide Lifeline eligibility will have no negative impact on Verizon revenues, citing Verizon’s response to recent PULP interrogatory requests.[31] PULP reiterates its view that if there is no provision to designate additional Lifeline qualifying programs, the Commission should reject the Joint Proposal. In response, Verizon counters that low-income New Yorkers have telephone service at a rate exceeding the comparable population nationwide, and that in November and December 2001 Lifeline customers increased by 11,000.

ChoiceOne

ChoiceOne "supports the Joint Proposal's spirit and goals," but expresses concern that the parties' understandings and agreements may not be fully reflected in the document. It

[30] PULP's Prefiled Testimony, p. 6.

[31] Verizon response to PULP-VZ-3B, Exhibit 15.

therefore seeks a series of clarifications.[32] Its requested clarifications include the Performance Assurance Plan, terms and prices for hot cuts, task force deadlines, service quality parity, and OSS cost recovery.

Finally, ChoiceOne asks for clarification that the Joint Proposal would apply to all carriers, whether or not signatories.

Public Comments

To inform the public about the joint proposal and to solicit public comment, the subject was featured on the front page of AskPSC.com, and an e-mail was sent to the business community. A press release announced the vehicles - the Opinion Line and the AskPSC.com - available for public comment and included a summary of the proposal's major provisions. The AskPSC.com website had a direct link to the Consumer Comment Form.

Thirty comments were received from the Opinion Line and through AskPSC.com. Most who commented were against the proposal; several offered a few general remarks related to both the Commission and Verizon; one person asked that meetings about the proposal be held in his area. A few people mentioned that they formerly worked for Verizon.

Of the public comments addressing relevant issues, the majority reflected concerns about rates, both now and what they would be under the proposal, high surcharges and taxes; poor quality of service; the lack of competition in parts of the State; and less frequent reporting under the proposal than what is presently in place.

After consideration of the comments, in the context of the balance of the record in this proceeding, we remain confident that the provisions of the Joint Proposal will improve the conditions for the growth of competition and protection of consumers, with an appropriate level of regulatory oversight.

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[32] ChoiceOne's Comments, pp. 1-2.

DISCUSSION

In our determination as to the terms of the Joint Proposal, we have considered the evidence in the records of these proceedings, including the parties' and others' statements, testimony adduced at the February 19, 2002 evidentiary hearing, closing statements at that hearing and the subsequent reply briefs. A number of concerns regarding specific terms or asserted omissions of the Joint Proposal are considered and decided here.

Requests for Clarification or Modification of the terms of the Joint Proposal.

Certain parties have requested clarification or modification of the terms of the Joint Proposal.

PULP proposes, as a condition for its support for the Joint Proposal, that residents who qualify for National Free/Reduced Lunch, the State Earned Income Tax Credit, and Child Health Plus be eligible for Lifeline. Verizon objects, stating that 8% of its customers receive Lifeline service, and that increases in its contributions to the state universal service fund, in particular, would be burdensome. Moreover, it is unclear whether the uncontested decline in Lifeline customers is attributable to changes in federal assistance programs or to increased scrutiny of customers' eligibility.

The Federal-State Joint Board on Universal Service is currently conducting a proceeding to determine what, if any, changes should be made in the federal low-income program eligibility. We will await the outcome of that review before addressing whether additional changes to the New York State program are advisable. Accordingly, noting that the Joint Proposal requires a reduction in the current connection charge for Lifeline to $5.00 and outreach and education programs, we adopt the relevant terms as proposed.

BridgeCom urges the Commission to clarify the extent of Verizon's obligation to provide the UNE platform under the terms of the Joint Proposal. In BridgeCom's view, the Pre-Filing Statement, as modified by the terms of the Joint

Proposal, guarantees that the UNE platform will be available without line limitation for residential customers statewide; and for business POTS customers in all central offices of the state, with the exception of specifically designated New York City central offices, without limitation as to the number of lines; and for business POTS customers in those New York City central offices where a customer uses 18 lines or less at a specific location. Further, BridgeCom seeks clarification that those designated New York City central offices are and will remain the 17 set forth in Verizon's 916 Tariff.[33] Staff, in reply, asserts that the Joint Proposal modifies the four-line restriction to 18 lines as to those central offices, but does not create any new restriction.[34] Staff replies that FCC requirements subsequent to the Pre-filing Statement limited UNE platform availability for business to customers with fewer than four lines in the designated New York City central offices (17 New York City central offices where, by the beginning of the Pre-Filing Statement duration period, two or more CLECs were collocated for the provision of local service). Verizon, also in reply, undertakes to provide the UNE platform at wholesale tariffed rates to a requesting competitor to serve a business customer with 18 or fewer lines in any part of its service territory. We see no ambiguity in the terms of the Joint Proposal and accordingly require Verizon to provide the UNE platform for business customers outside of New York City without restriction and in central offices in New York City that meet the two-

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[33] BridgeCom's Reply, p.4, citing PSC No. 10-Communications Tariff (filed August 1, 2001 to be effective September 1, 2001).

[34] BridgeCom also seeks clarification as to the duration period for the provision of the UNE Platform under the Pre-Filing Statement. We agree with Staff that the four- and six-year duration periods began with FCC approval of Verizon's New York §271 petition in December 1999.

collocation criterion for business customers with up to 18 lines for the duration of the Pre-filing Statement.[35]

Assemblyman Brodsky expresses concern about the abbreviated comment process on the Joint Proposal, noting that the negotiation process tends to leave the public with relatively little information about the proceeding.[36] Assemblyman Brodsky raises three concerns. He asserts, first, that the fairness and reasonableness of the proposed rate increase cannot be adequately understood within the time available for comment. Second, he objects to the Plan's failure to include funding for the functions previously performed by the Diffusion Fund created under the PRP as a means of improving telecommunications infrastructure in underserved low-income communities. He urges modification of the Plan to include such funding, in the amount of $10 million over two years, allocated among all market participants. Additionally he expresses concern over a reduction in service quality standards. He suggests the PRP's service quality requirements resulted in a significant improvement in service, objects to any loosening of standards, and urges continuation of service quality standards set on a regional basis. Assemblyman Brodsky's office reiterated at the evidentiary hearing these concerns about the absence of a technology diffusion fund from the VIP, retail rate and service quality concerns, and the adequacy of the process. As to rates and service quality we have considered the evidence and parties' arguments on these issues and see no reason to modify or reject the Joint Proposal. As to the diffusion fund, as Verizon points out in response, this issue is more appropriately considered in the broader context of universal

[35] In compliance with the UNE Order and in anticipation of Commission approval of the Joint Proposal, Verizon filed a tariff that establishes the terms and conditions for provision of UNE-P. As part of the filing, Verizon acknowledges, it incorrectly limited availability in 30 central offices, listed in Appendix B of Verizon Tariff Number 10. The proper reference should be Appendix C, that includes 17 central offices in New York City.

[36] Assemblyman Brodsky's Comments, p. 1.

service. The technology diffusion fund incorporated in the Performance Regulatory Plan predated the 1996 Act, which provides a comprehensive framework for universal service support on a competitively neutral basis. New York has participated in and benefited from the federal schools and libraries program, as well as a state Targeted Assistance Fund. It is in this context that proposals for additional funding must be raised. Accordingly, we see no need to modify the Joint Proposal in this regard. Finally, as to procedure, because of the opportunities for participation commencing with the May 2001 Verizon filing of a proposed incentive plan, and the active involvement of industry, consumer and government parties representing federal, state, and New York City government, we see no need to revisit the Joint Proposal and delay implementation of its benefits to competition.

The Attorney General, in a closing statement, expressed the hope that the terms of the Joint Proposal, in the context of the wholesale rates established in the UNE Order, would provide the needed transition to greater competitiveness for local telecommunications. While raising the concern that retail customers could be paying too much for too little service if competition fails to flourish, the Attorney General expressed a commitment to join in the effort to maximize competitive opportunities. As to the Attorney General's proposals to strengthen certain service quality performance targets and adjust the financial incentives, Staff responds that the Joint Proposal terms represent only minimal modification of current targets, that the Commission's current standard should be applied, that the outlier provisions in the Joint Proposal are sufficient to prevent backsliding, and that the link between rate flexibility and service quality provides ample additional financial incentive. In Verizon's view, it has fulfilled its obligations under the Performance Regulatory Plan and provided its customers excellent service, arguing for the Joint Proposal service quality plan which measures service using statewide annual averages, with outlier provisions protecting against problem areas. Having considered the comments of the Attorney

General and other parties, the public and the evidence before us, we conclude that the service quality-related terms of the Joint Proposal will provide the necessary protections for retail consumers for three years.[37] Moreover, the link between rate flexibility and service quality guarantees sufficient incentive for Verizon to comply.

Cablevision Lightpath seeks to add to the Joint Proposal a rebuttable presumption that a three-year extension of an existing interconnection agreement is in the public interest. Verizon opposes, on the grounds that the presumption would interfere with the balance of parties' rights under and is inconsistent with the 1996 Act. We are concerned about the costs to competitors and incumbents of protracted and burdensome negotiations and litigation concerning renewal of interconnection agreements. We agree the process can be streamlined but the proposed modifications raise substantial concerns and we are not prepared here to order them.

Choice One seeks clarification or modification of the Joint Proposal to require specific outcomes and timetables for the task forces created to explore new products and eliminate bottlenecks, in particular for facilities-based competitors. Verizon, in reply, expresses concerns about further regulatory burdens imposed in the form of the task forces. We will adopt the terms of the Joint Proposal with respect to the task forces, on the assumption that Verizon's commitment of resources, the good faith participation of all interested parties, the involvement of Staff and the guidance of the Office of Hearings and Dispute Resolution will result in timely and effective solutions wherever feasible. Moreover, should the task forces fail to reach agreement on the issues with which they are charged, disputes will be resolved by the Commission. In addition, we share the expectation of Staff that the IDLC review

[37] In Reply, Verizon clarifies, as Choice One requested, that the Performance Assurance Plan remains in effect according to its terms. We agree.

will be undertaken within the relevant task force, conducted during and completed prior to the end of the term of the Plan.[38]

General Discussion

The Plan affords ratepayers the opportunity to take advantage of the benefits of the coming competitive marketplace, while, at the same time, it provides the stockholders an opportunity to mitigate the financial impacts of the significant UNE price reductions.

According to the extensive analysis provided by Staff of the current status of competition in New York, as of the beginning of this year, approximately 27% of Verizon's local access line market was served by CLECs operating in Verizon's territory. The Commission has long fostered competitive markets and we believe the record supports findings that the local market is open and customers enjoy sufficient competitive alternatives. The review of various competitive entry strategies reveals that consumer benefit is maximized when competing services are offered via competing networks or via enhanced, value-added platforms. We recognize, as parties have noted, the recent setbacks to the development of competition, including the upheaval in the capital markets and observable, adverse effects of the UNE prices set in the First Network Elements Proceeding, which allowed insufficient margin between UNE prices and Verizon's retail prices. The Plan addresses certain of these concerns, along with the recently reduced UNE prices. The stability provided by the Plan (through such features as Verizon's agreement not to challenge the UNE rates and not to claim exogenous costs) and the Plan's other competitive enhancements related to UNE Platform availability, charges, procedures, and other matters, will enable CLECs to continue to compete in New York. The resolution of the competitive issues to be addressed by the task forces and other competitive enhancements under the Plan also will enhance opportunities for facilities-based competitors.

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[38] Staff testimony, Tr. 526.

With respect to retail service quality, the significant improvement since 1995 (when the current PRP went into effect), together with the positive impact of competitive pressures on service quality, warrant a new approach, directed less to bringing service up to predetermined targets and more to maintaining quality at the new, higher levels. The Service Quality Plan permits Verizon to freely compete and invest while protecting consumers from serious erosion in telephone service quality. With rebates that may be paid to customers if service quality falls, and performance objectives crafted to discourage pockets of poor performance, backed by Verizon's risk that pricing flexibility will be suspended if service quality declines significantly and a process for monitoring performance, service quality protections afforded by the Plan are effective.

With respect to retail rate flexibility, we are persuaded that the limited flexibility accorded Verizon in the VIP will enable it to respond to competitive pressures without rendering rates unreasonable.

CONCLUSION

Based upon the evidence in this record, we adopt the terms of the Verizon Incentive Plan contained in the Joint Proposal. We find the Plan will result in the continued provision by Verizon of safe and adequate service at just and reasonable rates, and that its terms will significantly enhance the conditions for local telecommunication competition in New York.

The Commission orders:

1. Verizon New York Inc. (Verizon) is directed to file tariff amendments that implement price changes consistent with this order to become effective on a temporary basis on one day's notice.

2. Within 15 days of the issuance of this order, Verizon is directed to file tariffs that implement any additional pricing flexibility consistent with this order to become effective on a temporary basis immediately upon filing.

3. Upon filing the tariff amendments consistent with Ordering Clauses 1 and 2 above, Verizon shall serve copies on all active parties to this proceeding. Any party wishing to comment on the tariff amendments may do so by submitting 10 copies of its comments to the Secretary within 15 days of the date the amendments are filed. The tariff amendments shall not take effect on a permanent basis until approved by the Commission, subject to refund if found not to be in compliance with this order.

4. With respect to charges for services other than First Line Basic Service, Verizon must notify the Commission and its customers of an exercise of upward rate flexibility no less than 20 days prior to such rates taking effect. With respect to charges for First Line Basic Service, after the first year, Verizon must notify the Commission and its customers of an exercise of upward rate flexibility no less than 30 days prior to such rates taking effect.

5. For good cause shown, the requirement of newspaper publication of the tariff amendments is waived.

6. Verizon shall provide a credit to carriers purchasing 2-wire and 4-wire loop hot cuts sufficient to offset the difference between the cost-based rates established in the UNE Rate Order and a $35.00 charge, with no additional associated service order charges.

7. Verizon shall provide $15 million for a Forward Fund to satisfy any potential liability for refunds to eligible competitive carriers arising out of the Commission's establishment of temporary rates for the switching element, net of any reciprocal compensation payments due and owing to Verizon.

8. Task Forces concerning new products and services and the elimination of bottlenecks will be convened by the Office of Hearings and Dispute Resolution.

9. The parties' requested modification of the Commission determination in the UNE Rate Order issued January 28, 2002, that rates for the loop/switch interface be reviewed in May 2002 is granted, and the determination is

modified to postpone the completion of that review until the termination of the Plan.

10. The terms of the Joint Proposal filed in this proceeding on February 8, 2002, subject to Verizon's unconditional acceptance of this order as described below, are adopted in their entirety and are incorporated as part of this order.

11. Verizon must submit a written statement of unconditional acceptance of this order, signed and acknowledged by a duly authorized officer of Verizon, by February 28, 2002. This statement should be filed with the Secretary of the Commission and served on all parties in this proceeding.

12. These proceedings are continued.

By the Commission,

(SIGNED) JANET HAND DEIXLER
Secretary

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Sandra DiIorio Thorn
Vice President & General Counsel, NY & CT

February 8, 2002

BY HAND

Honorable Janet Hand Deixler
Secretary
New York State Public Service Commission
Three Empire State Plaza
Albany, New York 12223

Re: Case 00-C-1945

Dear Secretary Deixler:

Enclosed please find the Joint Proposal Concerning Verizon Incentive Plan for New York.

Respectfully submitted,

Sandra DiIorio Thorn

cc: Honorable Jaclyn A. Brilling (By E-mail and Hand)
Honorable Joel A. Linsider (By E-mail and Hand)
Honorable Eleanor Stein (By E-mail and Hand)
All Active Parties (By E-mail and Overnight Delivery)

JOINT PROPOSAL CONCERNING VERIZON INCENTIVE PLAN

The undersigned parties jointly propose that the Public Service Commission approve the following Verizon Incentive Plan (the "Plan"). This Plan will supersede Verizon's Performance Regulation Plan which has been in effect since September 1, 1995 extinguishing all continuing rights and obligations under the Performance Regulation Plan.

The terms, conditions and underlying premises of the Plan are as described herein.

I. Premises: Verizon New York Inc.'s ("Verizon's") service performance under section 603 of the Commission's Rules is generally satisfactory and a service quality plan is in place to prevent backsliding to unacceptable performance levels. Active competition will exist across all market segments, UNE Rates will be as established by the Commission, UNE-P will remain available consistent with the Pre-Filing Statement of Bell Atlantic-New York, dated April 6, 1998 (the "PFS") as modified herein, and facilities-based competition will continue to develop.

II. Term of the Plan: The Plan is a two-year plan, beginning on March 1, 2002, with the Service Quality Plan extending one year beyond the Plan, through February 28, 2005.

III. Competitive Provisions

A. UNE Rates:

Rates for unbundled network elements and for the unbundled network element platform ("UNE" and "UNE-P") are as established by the Commission in its order in Case 98-C-1357, issued and effective January 28, 2002. The specific rates for the main elements and the platform are attached as Appendix A. As part of the proposed resolution, as described in C below, of the issues related to refunds described in the Commission's Order on Unbundled Network Elements

Rates,[1] the non-recurring charge for 2-wire and 4-wire hot cuts is $35.00, with no additional service order related charges.

B. UNE Availability:

For the term of this plan, notwithstanding any change in its obligations under Federal law, Verizon commits to modify its PFS commitments such that it will offer UNE-P to Competitive Local Exchange Carriers ("CLECs") serving small business customers (defined as business customers with 18 lines or less), on the same pricing and duration terms as its offering to CLECs for serving residential customers.

C. Relief Related to Temporary Switching Rate:

The issue of switching rate refunds is resolved as follows:

- For the term of the Plan, Verizon, in order to reach a settlement, agrees to a negotiated non-recurring charge for 2-wire and 4-wire loop hot cuts of $35.00 per loop, with no additional associated service order charges. This shall be accomplished by a credit provided by Verizon to the carrier sufficient to offset the difference between the cost-based rates established in the Commission's UNE Rate Order for these procedures and the $35.00 charge proposed herein.
- Verizon agrees to relinquish any right it may have to recovery of reciprocal compensation overpayments related to recalculation of switching costs or rates in the UNE Rate Order.
- Verizon agrees to provide $15 million (the "Forward Fund") to resolve the issues related to potential refunds to eligible competitive carriers. This Forward Fund payment will satisfy any potential liability for refunds arising out of the Commission's establishment of temporary rates for the switching element, net of any reciprocal compensation payments due and owing to Verizon.
- Eligibility for payment from the Forward Fund will be premised on the carrier's pre-existing right to seek retroactive relief based on having paid the temporary switching rate established in Verizon's tariff; no carrier shall be

[1] Case 98-C-1357-New York Telephone Company, Order on Unbundled Network Element Rates, issued

eligible for payment from the Forward Fund if it has obtained more than 5,000 hot cut lines in 2001 among all affiliates of such carrier. Only a carrier currently serving customers in the State of New York that relinquishes any claim it may have against Verizon related to switching rates for retroactive payments under interconnection agreements or otherwise will be eligible for payment from the Forward Fund.

- The Department of Public Service will conduct an expedited process in order to allocate the Forward Fund among eligible carriers. Any payments due to carriers from the Fund, net of reciprocal compensation paid to a carrier and its affiliates shall be made 50% in the form of an immediate bill credit and 50% in the form of bill credits over a 6-month period.

D. <u>Other Competitive Enhancements</u>:

1. <u>New Products and Procedures</u>:

The undersigned agree that they can and should share best industry practices in a number of areas to encourage competition and enhance cooperation between and among industry participants. While Verizon cannot commit to any specific outcome, it agrees to cooperate in a New Products and Services Task Force that will address a number of these issues, including best practices for billing and collection, building access and efficient provisioning for services where no facilities are available. The goal of the Task Force will be to attempt to establish processes and procedures that will standardize efficient wholesale transactions. No later than three months from the date of a Commission Order approving the Plan the Task Force will forward to the Commission a report detailing its findings, agreements and recommendations for industry best practices. The Task Force will focus specifically on the following:

a) <u>Billing and Collection</u>

- How to establish for all carriers a reasonable period of time for back billing, including the conditions under which exceptions would exist;
- How to develop billing verification tools for all carriers;

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and effective January 28, 2002 (the "UNE Rate Order").

- Whether reasonable procedures can be developed for initiating and responding to billing disputes for all carriers;
- Whether procedures/methods applicable to all carriers can be developed to minimize overbilling.

b) EELs/UNEs

- To facilitate the provisioning of service when a UNE order is rejected due to "lack of facilities", the Task Force will attempt to establish applicable pricing and provisioning protocols so that facilities can be provisioned in a reasonable time frame and at a reasonable price that is consistent with Verizon's retail offerings.

c) Virtual Building Connection Product

- Without any relinquishment of rights parties to the Task Force may otherwise have, and where legally and technically feasible, the Task Force will attempt to develop a product(s) to enhance carriers' ability to gain access to buildings.

2. **Elimination of Bottlenecks to Migrating Customers from UNE-P to CLEC facilities**:

Verizon will establish a Bottleneck Elimination Task Force to work with CLECs and staff to solve urgent facilities, hot cuts and other bottleneck problems. The Task Force will report back to the Commission on the status of these issues within 6 months.

IV. Service Quality Provisions

A. Retail Service Quality Plan: The following plan (the "Service Quality Plan") ensures the continued provision of quality telephone service for Verizon. The conditions of the Service Quality Plan are as follows:

Service Quality Term: The term of the overall Verizon Incentive Plan plus one year.

Definitions:

- Market Area: Verizon's operating area in the State of New York.

- Measurement Period: Twelve-month period. The first measurement period ends February 28, 2003.
- Redundancy Failure: A failure that occurs as a result of Verizon having an actual level of diversity less than the level Verizon certifies annually as existing in the Signaling System 7 ("SS7") and Enhanced 911 ("E911") networks where the appropriate level of diversity is determined in accordance with NYCRR 603.5(b)(3). Verizon's annual certification due July 1st each year over the Service Quality Term will detail the actual level of diversity in the SS7 and E911 networks overall as of the prior Calendar Quarter.
- Review Period: Annual period ending with the close of each Plan Quarter; the first review period ends February 28, 2003.
- All other terms are as defined in the Commission's Telephone Service Standards, Special Service Guidelines, and the Department's Emergency Plan.

Performance Objectives: The following objectives are the foundation of the Service Quality Plan and apply in the market area for each Measurement and Review Period.

- **Troubles:** Customer Trouble Report Rate ("CTRR") equal to or less than 3.3 per hundred access lines.
- **Out-of-Service:** Average percent out-of-service over 24 hours equal to or less than 20%.
- **Installation:** Average percent of initial basic service installed within 5 days or less greater than or equal to 80%.
- **Complaints:** A rate of less than 5.5 complaints per 10,000 lines.[2]
- **Outliers:[3]** No more than 175 Service Inquiry Reports filed in the initial Measurement Period, and 125 in any subsequent period where the number of service inquiry reports are determined in accordance with Appendix B.[4]

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[2] The Complaints target in this Plan presumes existing Public Service Commission complaint handling procedures. If, as a result of changes to either the complaint handling procedure or the types of complaints that are counted against Verizon, the degree of effort needed to meet this target is materially modified, Verizon and staff agree to adjust the Complaints target to reflect the impact of the reviewed procedures on Verizon's expected performance.

[3] The Outliers targets were determined by considering only certain service inquiry reports (i.e., based on trunks that originate and terminate at Verizon facilities only). Verizon agrees that it will also measure

Enforcement: Service related data will be provided to the Commission. Additional information staff deems appropriate will be provided upon request to the extent required by the Public Service Law.

Service Measurement Accuracy

1. Verizon's Quality Assurance Team ("QAT") shall ensure the internal controls are reasonably sufficient to assure net error rates of 5% or less in each measurement entity (*i.e.*, the percent of under-reporting errors minus the percent of over-reporting errors must be 5% or less) by the following:

    a) Monthly sampling reviews will be performed at the IMC level to assure accurate results. Any IMC that exceeds a (+/-) 1% Net Error rate will be subject to an adjustment of results based on a twelve-month rolling average of the monthly adjustment factors to be developed as the Plan progresses;
    b) The QAT will communicate the outcome of the sampling process with field directors who will take corrective actions to improve measurement accuracy. Staff shall be advised of any corrected results and remedial actions;
    c) Adjustments will be performed for Customer Trouble Report Rate (CTRR), Out of Service >24 Hours, and Service Affecting > 48 Hours measurements;
    d) If any measurement entity exceeds a (+/-) 5% Net Error rate, the Director will be required to prepare a written report indicating the analysis and corrective actions to be taken to insure accurate results. The QAT will monitor and insure compliance with this requirement;

performance in a way that includes not only trunks that originate and terminate at Verizon owned facilities but trunks that terminate at facilities owned by other carriers (such as competitive local exchange carriers, interexchange carriers, and wireless carriers); however the latter will not be included for the purposes of the Service Quality Plan. Verizon also agrees that it will work closely with other carriers and Staff to limit the number of trunk blockages that occur.

[4] For the Outliers component of this Plan, the Maintenance and Installation service standards are measured on a Central Office and Installation Maintenance Center ("IMC") basis, except, however, that those

e) The QAT will implement the Manager Sampling Plan and the procedures for handling allegations of mis-reporting from the CWA "Hot-Line" (the "CWA Hot-Line Process") that are developed in compliance with the requirements of the Commission's "Order Adopting Report," issued May 17, 2001 in Case 01-C-0440 (the "May 2000 Order");

f) Each year the President of Verizon New York will attest to the fact that Verizon has implemented the above service measurement accuracy activities to be performed by the QAT.

2. Outside Review

a) Each year that the Service Quality Plan is operative Verizon shall hire an independent external auditor (hereafter Auditor) to review the procedures employed by the QAT (including the QAT process to sample and adjust results), the Manager Sampling Plan, the CWA Hot-Line Process, and other QAT oversight activities (e.g., answer time, installation and network blockage service quality measurements). As part of this review, the Auditor will perform a sampling of the QAT sample for comparison with the results obtained by the QAT. The Auditor will issue a report setting forth its findings based on its review of the QAT process;

b) If the Auditor finds any entity with a total gross error rate over 30%, a substantive audit of that entity by the Auditor shall be required. (This is not intended to limit the Auditor from recommending specific actions, such as a substantive audit, if an entity has a gross error rate less than 30%, but to serve as an out-of bounds requirement for specific action.) The total gross error rate is the sum of under-reporting errors plus the over-reporting errors;

c) The Request for Proposal ("RFP") for hiring the Auditor shall be reviewed by staff and interested parties prior to issuance.

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standards that are measured on an IMC basis can be changed to a Dispatch Resource Center basis or another, more highly aggregated basis, upon approval of Staff.

d) If the Auditor determines that Verizon has complied with the procedures to reasonably ensure accurate results as required herein, a detailed audit shall not be required. If the external auditor determines there were major deficiencies in Verizon's compliance, a detailed audit of the results for the year in question shall be conducted by the Auditor. The Auditor shall review compliance with the 5% net error process for each entity that exceeds a 5% net error rate to ensure that corrective actions are being taken; and

e) The Auditor shall make an annual report to Verizon of its findings and recommendations and this report shall be submitted to the Commission and provided to interested parties.

3. Verification of Penalty Payments – Verizon agrees to ensure that all penalties are issued accurately. This shall be accomplished by utilizing the existing Performance Regulation Plan rebate process currently employed by the QAT. When a credit is given, Verizon shall use the QAT to verify that customers received the appropriate credit. Verizon's internal auditors shall verify this on an annual basis. Credits will be paid in 90 days from the date the service quality results measured under this plan are finalized. Verizon will provide Staff with a report detailing the credit payments made.

Service Quality Link to Pricing Flexibility: If Verizon fails two Performance Objectives at the end of any Review Period, the following applies:

- Prospective pricing flexibility as provided in the Plan is suspended;
- Pricing flexibility is not restored until Verizon passes each performance objective for three consecutive months based on a rolling twelve-month average.[5]

[5] Should Verizon experience a company-wide work stoppage during the course of this Plan that causes Verizon to miss performance objectives set forth herein, Verizon can petition the Commission for an adjustment to and normalization of its performance results and can proceed to exercise its pricing flexibility pending the Commission's decision on that petition. Normalization of results will be performed in accordance with the service quality normalization process set forth in the March 13, 2001 memorandum from the Office of Communications to the Commission attached to the Commission's "Order Granting In Part and Denying In Part Requests for Waivers of Service Quality Targets," issued June 7, 2001 in Case 92-C-0665.

If Verizon fails a performance objective in a Measurement Period, a rate adjustment, as described below, applies.

Performance Rate Adjustments: Verizon will credit customer rates in the Market Area if a performance objective is not met in a Measurement Period as follows:

- Following are the total credit amounts available in a Measurement Period if Verizon misses one or more performance objectives. These total credit amounts will be divided by the number of performance objective(s) that were missed in that period to determine the credit amount payable on each missed performance objective:
    - ♦ If a single objective is not met, the total credit amount available is $15 Million.
    - ♦ If two objectives are not met, the total credit amount available is $40 Million.
    - ♦ If three or more objectives are not met, the total credit amount available is $100 Million, plus an additional $35 Million for each objective above three that is not met.
- In any case where Verizon misses the PSC Complaint or the Outliers performance objective in a Measurement Period, the total credit amount available for that performance objective will be distributed on an equal per access line basis in the Market Area;
- In any case where Verizon misses the Troubles (CTRR), Out-of-Service, or Installation performance objective in a Measurement Period, the total credit amount available on that performance objective will be distributed on a per occurrence basis to each affected customer who experiences a service problem that is measured in the performance objective(s) that was missed in the Measurement Period;[6]

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[6] Affected customers is defined as follows:
- Troubles – all lines with a measured trouble during the measurement period
- OOS – all lines out-of-service longer than 24 hours in the measurement period
- Installation – all basic line installations taking longer than 5 days in the measurement period

- In no instance will a credit to any one affected customer exceed $50 per occurrence in a Measurement Period. If as a result of this restriction a portion of the total credit amount available remains unpaid, the unpaid amount will be distributed on an equal per access line basis in the Market Area.

Major Service Interruption: Verizon agrees that no major service interruptions will occur as a result of a Redundancy Failure in its Signaling System 7 or E911 network after July 1, 2002. Upon a finding by the Commission that a failure did occur after that date, Verizon agrees to make a payment of $100,000 into the State's General Fund.

Special Services Service Quality

Verizon has agreed to implement the special services process improvement program with related improvement milestones and customer credits, as more fully described in a letter to the Department of Public Service dated February 8, 2002.

V. Pricing Flexibility Provisions

Verizon will be allowed pricing flexibility beginning March 1, 2002 in accordance with the conditions listed below.

Conditions:

Upward flexibility is allowed on all services and products consistent with the Service Quality Plan, with the following exceptions:

- UNE prices
- Wholesale discounts for services offered for resale
- Interconnection and reciprocal compensation prices
- Lifeline services
- Maintenance and access to the ALI database
- Directory Assistance and other database inquiries for competitive providers
- Non-recurring service connection charges for residential and small business customers
- Certain services previously ordered to be provided at no charge, for example, call blocking or PIC freezes

There is no cap for increases in the rates for individual services except for 1FR service[7] in Rate Group 1, 3 and 5[8], except that any increase in the charges for First Line Basic Service shall not exceed $1.85 per line in the first year and $0.65 per line in the second year.[9] Downward pricing flexibility is limited only to a rate equal to Verizon's incremental cost and usage offerings must pass an imputation standard. Rates for Carrier Access Services may not increase.

Overall revenue increases associated with pricing flexibility are capped at 3% on an annualized basis each Plan year, using units in service for all services for the prior year over any annual period.[10]

Under no conditions is flexibility is allowed:

- If pricing flexibility is suspended under the terms of the Service Quality Plan.
- Unless Verizon agrees to take full responsibility to explain the need or rationale for any flexible price increase to its customers and that all communications with customers will explain that the basis for any flexible price increase is solely its business decision.

VI. Financial Consistency and Additional Regulatory Protections

Verizon shall conform amounts reported on its New York State regulatory financial reports with the amounts it reports in its filings with the Securities and Exchange Commission (e.g., 10K). This transformation shall occur over a three-year period beginning on the first day of the Verizon Incentive Plan.

Depreciation expense recorded during the term of the Verizon Incentive Plan shall be equal to the sum of the depreciation recorded on the SEC books plus a three-year

[7] 1FR service is a residential service consisting of the basic line charge and flat rate local usage.
[8] The total increase to the price of 1FR service in rate group 1 shall not exceed $2.00 in the first year of the Plan and $2.00 in the second year. The total increase to the price of 1FR service in rate groups 3 and 5 shall not exceed $2.00 in the first year of the Plan and $3.00 in the second year.
[9] Under this Plan, First Line Basic Service is defined as the first line for a particular customer at a particular location for basic service access, basic message rate, individual message business lines and analog PBX trunks.
[10] Staff will be provided with the units-in-service for all services and the price changes put into effect each Calendar Quarter over the term of the Plan to assure this condition is met.

amortization of the difference between the depreciation reserve recorded on the SEC books and the depreciation reserve recorded on the state regulatory books as of the first day of the plan. At the end of the three-year amortization period, the depreciation reserve used for state regulatory purposes will thus be equal to the SEC depreciation reserve.

During the term of the Verizon Incentive Plan, neither regulatory assets nor regulatory liabilities shall be created, with the exception of Commission approved net costs associated with the restoration of the World Trade Center aftermath. All existing regulatory assets and liabilities shall be fully extinguished by the end of this plan in accordance with the first paragraph above. Any changes to GAAP as promulgated by the accounting profession will be implemented for both the SEC books and the state regulatory books.

Verizon shall be allowed to account for pension and other post employment benefit obligations (“OPEB”) consistent with SFAS #87 and SFAS #106. This includes allowing Verizon to retain the benefit/detriment of financial accounting gains/losses during the term of the Verizon Incentive Plan. In no event will Verizon be allowed to withdraw plan assets other than to pay benefits, including administrative expenses, or settle benefit obligations associated with its pension and OPEB plans. Verizon commits to obtain New York State Public Service Commission approval prior to annuitizing, curtailing, or otherwise settling all or substantially all of Verizon’s pension plan/OPEB obligations for employees of regulated entities in New York state. The Commission will be notified if there are any major changes in these plans, if “assumptions” change materially, and if plan assets are used for purposes other than directly paying benefits and related administrative expenses.

VII. Infrastructure

To assure investments commensurate with good service quality, Verizon agrees to:

- File annual construction budgets that identify service-related investments
- Meet with staff on an annual basis to provide an overview of its construction budget with an emphasis on:
  1. Service quality improvements
  2. Increased network reliability

3. Deployment of new technology, including a demonstration that the introduction of new services and technologies is non-discriminatory
4. Deployment of advanced services

- Provide with each annual construction budget filing an overview of Verizon's plans and progress toward introducing new technology and advanced services and to identify new services to be provided

To assure reliability consistent with post-9/11 best practices

- As changes to the Network Reliability and Interoperability Council's "best practices" and industry standards reflecting lessons learned from incidents such as the events of September 11, 2001 are developed, Verizon, will, by July 1st of each year over the term of the Verizon Incentive Plan, inform the PSC Staff of its intention to implement the practice or standard. Verizon will also report to the Staff, on an annual basis, the progress it is making toward the implementation.
- Participate in industry/governmental forums concerning network reliability.
- Cooperate in the development of data to be used by the staff in its Geographic Information System designed to provide service outage information to the Commission and the State of New York.

VIII. <u>Miscellaneous</u>:

A. <u>Exogenous Costs and Merger Savings</u>

With respect to the matters under consideration in Case 00-C-1945 with respect to outstanding exogenous cost filings and merger savings (the so-called "White Paper" issues), the parties propose that the Commission find that available merger savings fully offset otherwise allowable cost onsets and exogenous costs, and that Ordering Clauses 5 and 6 in the Order Approving the Bell Atlantic/NYNEX Merger, issued and effective March 21, 1997, and the Order Approving the Bell Atlantic/GTE Merger, issued and effective August 12, 1999, have been satisfied in a way that Verizon relinquishes its claim to rate increases as a result of exogenous costs, and such merger saving shall not be used to require rate reductions as contemplated in those Order Clauses.

Verizon agrees to withdraw its revisions to Tariff P.S.C. No. 10 -Communications filed May 29, 2001,as well as those rates proposed in its supplemental filings in Case 00-

C-0127, relating to recovery of OSS costs for Line Sharing, Line Splitting, Unbundled Sub-Loop Arrangements, Feeder Sub-Loops, and other DSL-related items.

B. Reservation of Authority:

The parties recognize that the Commission reserves the authority to act on the level of Verizon's rates and service pursuant to the Public Service Law should it determine that intervening circumstances have such a substantial impact as to render Verizon's rates unjust or unreasonable or render this Plan unreasonable, unnecessary or insufficient for the continued provision of safe and adequate service by Verizon-New York. Should the Commission exercise this authority, Verizon has the right to withdraw from this Plan.

C. Reconsideration and Judicial Review

During the term of this Plan, Verizon agrees that the rates prescribed by the Commission's UNE Rate Order will remain in effect and that it will not challenge those rates before the Commission or in court. For purposes other than challenging the rates prescribed in the Commission's UNE Rate Order, Verizon does not relinquish any legal or equitable rights it may have with respect to the underlying theory of the case, including, but not limited to, the cost recovery theory known as TELRIC. This commitment should not be interpreted as a voluntary agreement for purposes of the Bell Atlantic/GTE FCC merger conditions as to the level of rates, the rate design or the theory of the case. If the aforementioned decision is appealed or otherwise challenged by any person or entity, Verizon, in supporting the Commission's decision in Case 00-C-1945 reserves all legal and equitable arguments it would otherwise have had.

The parties propose a modification of the PSC determination that rates for the loop/switch interface be reviewed in May 2002 to reflect IDLC connections, where appropriate.[11] The modification consists of postponing that review until the termination of the Plan.

D. Lifeline

- Reduction in the present connection charge from $10 to $5.
- Maintain an outreach and education program for Lifeline

[11] UNE Rate Order, pp.93-95.

E. Consumer Outreach and Education:

Verizon will design and implement, within existing consumer education budgets, an outreach and education program to inform customers about their rights and responsibilities and special programs, such as Lifeline and the Relay Service.

Unbundled Network Element Rates

Verizon's major unbundled network element ("UNE") rates per UNE Rate Order.

UNE	Old Rate	New Rate
2-Wire Analog Loop Rate[1]		
Manhattan	$11.83	$7.70
Major cities	$12.49	$11.31
Rest of State	$19.24	$15.51
Line Port	$2.50	$2.57
Local Switching		
Originating	$0.003150	$0.001147
Terminating	$0.003150	$0.001111
End Office Trunk Port	$0.000656	$0.000371
Common Transport	$0.000783	$0.000203
Tandem Switching	$0.001017	$0.000481
Tandem Trunk Port	$0.001464	$0.000570

Note – The old rates for local switching were not deaveraged between originating and terminating. The old rates for all usage based rates were time of day sensitive (day, evening & night). The amounts shown are a weighted-average based on actual usage by CLECs leasing Verizon's UNE-P in the first months of 2001.

Utilizing the methodology employed by Verizon in its supplemental response to Staff interrogatory PSC-VZ-18 in Case 00-C-1945, these rates will impact the average monthly cost of Verizon's UNE-P as follows.

UNE	OLD	NEW
Loop	$14.05	$11.49
Port	2.50	2.57
Average Usage per Line	10.61	5.08
Revenue Per Line	$27.17	$19.14

[1] These are melded integrated digital loop carrier (DLC)/ universal DLC rates as only one rate is to be charged for all loops leased.

Service Inquiry Reports for the purposes of measuring Outliers under the Service Quality Plan are the sum of the following in any Measurement Period:

Service Inquiry Reports = Unadjusted Service Inquiry Reports $_{\textbf{Current Year}}$ + (Total Credits $_{\textbf{Prior Year}}$ + 50% of Total Credits $_{\textbf{Prior Year –1}}$)

TOTAL CREDITS COMPUTED AS FOLLOWS

Formula	Credits
One Unadjusted SIR for any single Measure[1]	5 per measure
No Unadjusted SIR for any single Measure	10 per measure
More than 50 Unadjusted SIRs for any measure	Minus 2 credits for each measure
More than 2 consecutive Unadjusted SIRs for any entity	Minus $^{1}/_{10}$ credit times the number of SIRs in excess of 2 for each such entity
Total Credits	Sum of the above

Total Credits for any year may be zero, but not negative.

[1] There are ten measures defined in NYCRR 603.4(d)(1); however, Answer Time Performance Results (for Business Office, Repair Office, and Operator Assistance) are consolidated and considered a single measure for the purpose of determining credits. Thus, there are eight measures for the purpose of determining service inquiry report credits under the Service Quality Plan.

Case 00-C- 1945

IN WITNESS WHEREOF, the parties have duly executed this agreement, as of February 8, 2002.

VERIZON NEW YORK INC.

BY: Sandra DiIorio Thorn

NAME: Sandra DiIorio Thorn

TITLE: VP & General Counsel, NY & CT

Case 00-C-1945

IN WITNESS WHEREOF, the parties have duly executed this agreement, as of February 8, 2002.

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Attorney General of the State of New York

New York City Department of Information Technology and Telecommunications

Public Utility Law Project

Communications Workers of America

AT&T Communications of New York, Inc.

WorldCom, Inc.

COVAD Communications Company

Citizens Communications

Competitive Telecommunications Association

Time Warner Telecom, Inc.

Focal Communications Corp. of New York

Allegiance Telecom

Network Access Solutions Corp.

XO Communications, Inc.

Cablevision Lightpath, Inc.

Sprint Communications Company, L.P.

Conversent Communications of New York

Z-Tel Communications, Inc.

New York State Telecommunications Association, Inc.

Choice One Communications, Inc.

Network Plus, Inc.

RCN Telecom Services, Inc.

XO New York, Inc.

Mettel

Broadview Networks, Inc.

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